The Return of the "Giant Sucking Sound"?

By **Joseph Quinlan** | Friday, October 17, 2003

In following the debate over international trade, one is led to believe that it is all a one-way street: The developing countries export as if there is no tomorrow, while the rich countries — especially the United States — are mass importers. But is this really the whole story? Joseph Quinlan examines this issue going back to the 1980s and 1990s — and presents some surprising findings.

It was during the 1992 presidential debate that Ross Perot coined the phrase "giant sucking sound" to describe the potential loss of U.S. jobs to Mexico on account of the North American Free Trade Agreement (NAFTA).

A "sucking sound" of a different sort

Many observers scoffed at Mr. Perot's rhetoric, although the Texan was onto something.

Soaring import demand from the developing nations was key to softening the blow of recession in both the United States and Europe in the early 1990s.

There was indeed a powerful "sucking sound" in the 1990s.

It was not, however, the kind Mr. Perot had warned of — namely, U.S. jobs being lost to low-wage nations like Mexico. Rather, it was the powerful — and positive — sound of surging import demand from the developing nations.

Soaring import demand from the developing nations was one of the most important drivers of the global economy in the 1990s.

The cause

Rising per capita incomes, the emergence of a middle class in countries such as China and Brazil, the integration of central Europe and Russia into the global economy, trade and investment reforms. All of these factors and more converged in the early 1990s to produce an incredible consumption boom in the developing nations.

With the above dynamics at work, the developing nations shifted from being a source of global supply (that is, net exporters) in the 1980s to a source of global demand (net importers) in the 1990s.

Profits for the rich

The main beneficiaries of this boom were the industrialized nations. Indeed, soaring import demand from the developing nations was key to softening the blow of recession in both the United States and Europe in the early 1990s.

Thereafter, the developing nations remained a key source of demand for U.S., European and Japanese firms. Developing nations' imports from the industrialized nations more than doubled between 1989 and 1995.

In 1989, the year the Berlin Wall was toppled, imports into the developing nations from the industrialized world totaled $503 billion. By 1995, these imports bill totaled than $1 trillion, with the developing nations accounting for 34% of world imports, up from a 27% share in 1989.

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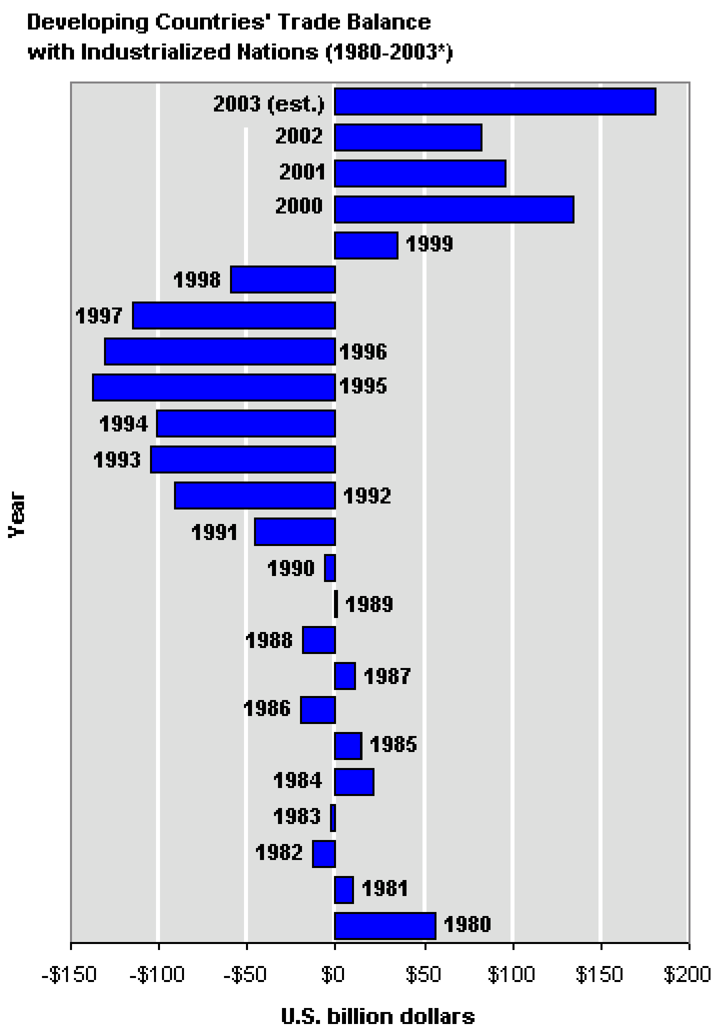
Benefits for the developing world?

More importantly, the trade balance of developing nations with industrialized countries swung from a modest surplus of nearly $1 billion in 1989 to a sizable deficit by the mid-1990s (see chart below).

Deficits: A Slippery Slope



Data Sources: International Monetary Fund; Banc of America Capital Management. © 2003 by The Globalist

Given soaring demand for virtually everything — from potato chips to computer chips — developing nations saw their trade deficit with industrialized economies climb from $6 billion in 1990 to more than $90 billion just two years later.

In 1993, the trade deficit topped $100 billion. It peaked at $137 billion in 1995, and stayed above $100 billion in 1996 and 1997.

A change of winds

The Asian financial crisis caused the deficit to narrow to $59 billion in 1998. Asia (excluding Japan) — the largest regional importer among the developing nations — sharply curtailed its import demand in 1998. This led to a 6.2% decline in total imports among the developing nations.

By 1999, the deficit had swung to a surplus of $35 billion. Yet, on a cumulative basis the net trade deficit of the developing nations with the industrialized countries totaled a staggering $754 billion in the 1990s. That number stands in stark contrast to the cumulative trade surplus of only $57 billion during the 1980s.

Back to the future?

At present, the developing nations are hardly a collective source of demand. Their massive trade deficits of the 1990s have been transformed into massive surpluses.

The developing nations shifted from being a source of global supply — that is, net exporters — in the 1980s to a source of global demand — that is, net importers — in the 1990s.

During the 2000-02 period, for instance, the developing nations’ cumulative trade surplus with the industrialized nations totaled a whopping $313 billion — the bulk of it courtesy of U.S. demand.

Through the first four months of this year, the developing nations’ trade surplus with the industrialized world topped $60 billion, equivalent to an annualized total of $180 billion. That would mark a record annual surplus — and bring the four-year cumulative total (2000-03) to nearly $500 billion.

What to look forward to?

The question today is whether a sustained decline in the dollar will help to revitalize the dormant import demand from developing nations.

If America gets its wish — i.e., “more flexibility in exchange rates” — the upshot should be more stimulative policies and aggressive structural reform measures. This would happen not only in Europe and Japan — but also in South Korea, China, Poland and Brazil.

A hope for global rebalancing

In other words, a dollar that is weaker against the currencies of the developing nations could help to force the pace of long-term structural change — while giving a near-term boost to U.S. exports.

In addition, stronger currencies that are relative to the dollar should give those countries' monetary authorities (such as in Korea and Taiwan) the leverage to lower interest rates.

This should help shift the composition of growth away from exports and toward domestic consumption and private investment. Accomplishing this shift remains a critical component of global rebalancing.

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What we learned

The bottom line is this: Contrary to the warnings of Ross Perot, we should not think of the developing nations as simply sources of global supply while failing to recognize their potential role as a source of global demand.

If the U.S. dollar is in a multi-year decline — and I think it is — then that "giant sucking sound" is poised for a comeback.

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